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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

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UNITED STATES OF AMERICA

- against -

VICTOR SUGLIA,

Defendant.

- - - - - - - - - - - - - - - - x

I N F O R M A T I O N

Cr. No. 07-033 (NG)
(T. 18, U.S.C., §§ 1349 and 3551 *et seq.*)

THE UNITED STATES ATTORNEY CHARGES:

INTRODUCTION

At all times relevant to this Information, unless otherwise indicated:

I. Background

A. The Company

1. Friedman's Inc. ("Friedman's" or the "Company"), was a Delaware corporation with its headquarters and principal place of business located in Savannah, Georgia. Friedman's was the third-largest specialty retailer of fine jewelry in the United States. As of September 2003, Friedman's operated approximately 686 stores in 20 states. Friedman's reported over $400 million in net sales in each of its fiscal years ending September 2001 and 2002.

2. Friedman's was a publicly traded corporation, the Class A common stock of which was listed on the New York Stock

Exchange from June 2003 through May 2004 under the ticker symbol "FRM". Prior to June 2003, Friedman's Class A common stock was traded on the NASDAQ. The holders of Friedman's Class A common stock were located throughout the United States, including in the Eastern District of New York.

3. As a public company, Friedman's was required to comply with the rules and regulations of the United States Securities Exchange Commission (the "SEC"). The SEC's rules and regulations were designed to protect members of the investing public by, among other things, ensuring that a company's financial information was accurately recorded and disclosed to the investing public.

4. Under the SEC's rules and regulations, Friedman's and its officers were required to (a) make and keep books, records and accounts that, in reasonable detail, fairly and accurately reflected the Company's business transactions, including its earnings, revenue and expenses; (b) devise and maintain a system of internal accounting controls sufficient to provide reasonable assurance that the Company's transactions were recorded as necessary to permit preparation of financial statements in conformity with Generally Accepted Accounting Principles ("GAAP"); and © file with the SEC quarterly reports (on Form 10-Q) and annual reports (on Form 10-K) that included financial statements that accurately presented Friedman's

financial condition and the results of its business operations in accordance with GAAP. Friedman's and its officers were also required to have these annual reports reviewed by an independent, outside auditor.

B. The Defendant

5. The defendant VICTOR SUGLIA was employed by Friedman's as Chief Financial Officer and Senior Vice President from approximately June 1997 to November 2003, reporting to Friedman's Chief Executive Officer. In November 2003, SUGLIA was placed on a leave of absence by the Company's Board of Directors. SUGLIA resigned from Friedman's in December 2003. From in or about September 1999 to November 2003, SUGLIA also served as the Chief Financial Officer of Crescent Jewelers ("Crescent"), an affiliate of Friedman's.

6. As detailed below, SUGLIA and his co-conspirators engaged in a scheme to defraud investors by, among other things, falsifying Friedman's accounting data and misrepresenting Friedman's financial condition in public statements and reports. In furtherance of the scheme, documents related to Friedman's SEC filings were sent by mail using an interstate carrier.

C. Friedman's Installment Credit Program

7. Friedman's business targeted low to middle income consumers ages 18 to 45 and offered a selection of fine jewelry to that market. Friedman's offered an installment credit

program, which the Company described as an "integral part" of its business strategy, to help its customers finance their purchases. In Friedman's fiscal year ending September 28, 2002, the last year for which Friedman's filed an annual report, the majority of the Company's sales were made on credit.

8. Given that such a large portion of Friedman's business involved credit sales, analysts and investors needed to assess the likelihood that Friedman's would be able to collect on these credit sales in order to evaluate whether to buy, hold or sell Friedman's stock. Accordingly, Friedman's public filings made specific disclosures about the operation of its installment credit program. Friedman's also identified the uncertainty of its credit business as a risk factor to individuals deciding whether to invest in the Company.

9. Friedman's public filings also made representations about the Company's policy with respect to charging off credit accounts that appeared to be uncollectible. To "charge off," or "write off," an account meant to reduce the balance of that account to zero.

D. <u>Friedman's Accounts Receivable</u>

10. Under GAAP, Friedman's was required to record on its books the total amount of money owed to the Company by customers who bought jewelry and other items on credit. This amount was recorded as an asset known as "accounts receivable."

Under GAAP, when a credit account at Friedman's was charged off, that is, when a credit account was removed from its books, the Company was required to reduce accounts receivable in an amount equal to the charge-off amount. Friedman's quarterly and annual reports disclosed the Company's total accounts receivable as of the end of the period covered by that report.

(1) Currency and Delinquency Percentages

11. Friedman's ability to collect on its outstanding credit accounts was important to analysts and investors. As a result, Friedman's provided information to the market about the extent of delinquency of the Company's accounts receivable at the end of each reporting period.

12. This information included data regarding the amount of time that these accounts were past due, which Friedman's referred to as the "currency" percentage and the "delinquency" percentage. Friedman's defined the "currency" percentage as the portion of Friedman's accounts receivable that was owed by customers whose accounts were less than 30 days past due. Because these customers were up to date on their payments, Friedman's was most likely to collect the money owed to the Company by these customers. Friedman's defined the "delinquency" percentage as the portion of Friedman's accounts receivable that was owed by customers whose accounts were greater than 90 days past due. Because all of these customers had missed several

payments, Friedman's was least likely to collect the money owed to the Company by customers in this category.

13. Friedman's publicly disclosed the currency and delinquency percentages of its accounts receivable at the end of each reporting period. Analysts and investors used the currency and delinquency percentages to evaluate the future collectibility of Friedman's accounts receivable and to value Friedman's common stock.

(2) <u>The Allowance for Doubtful Accounts</u>

14. Under GAAP, Friedman's was required to estimate the amount of the Company's accounts receivable that it expected to be uncollectible. The Company was required to record this amount on its books in what was known as a "reserve." The name of this reserve was the "allowance for doubtful accounts."

15. Each quarter, Friedman's reported its allowance for doubtful accounts as a percentage of its total accounts receivable. Under GAAP, Friedman's was required to subtract from earnings amounts added to its allowance for doubtful accounts reserve, so that the Company's earnings only included credit sales that the Company truly expected to collect.

16. The allowance for doubtful accounts percentage was an important number for investors. Among other things, it was used by analysts and investors to assess the future profitability of the Company.

II. The Securities Fraud Scheme

17. The defendant VICTOR SUGLIA, together with Friedman's Chief Executive Officer and others, engaged in a scheme to misrepresent Friedman's true financial condition to the Company's shareholders and the investing public. In furtherance of the scheme, SUGLIA, Friedman's Chief Executive Officer and others caused Friedman's to file financial reports and made other public statements that contained material misrepresentations and omitted facts necessary to make these statements truthful and not misleading, regarding, among other things: (1) the operation of the Company's installment credit program; (2) the delinquency and collectibility of the Company's outstanding credit accounts; and (3) the Company's earnings. The misleading portrayal of Friedman's financial condition artificially and materially inflated Friedman's stock price.

A. Misrepresentations Regarding the Operation of Friedman's Installment Credit Program

18. In or about and between 2001 and 2003, Friedman's public filings contained materially false and misleading statements about the operation of the Company's installment credit program. These public filings stated that the Company "adhere[d] to strict credit application guidelines in determining whether our customers qualify for credit." The filings further stated that the Company used a computer credit scoring process to determine whether a customer should be approved for credit and,

if so, the amount of credit that should be extended.

19. As the defendant VICTOR SUGLIA and Friedman's Chief Executive Officer knew, Friedman's public statements about the strict operation of its credit granting policies and procedures were false and misleading. Although Friedman's had promulgated strict credit-granting guidelines, Friedman's employees, with the knowledge of senior management, including SUGLIA, routinely extended credit to customers in violation of the Company's guidelines.

20. SUGLIA and other senior Friedman's executives concealed Friedman's failure to adhere to its credit guidelines from the investing public. SUGLIA and Friedman's Chief Executive Officer approved Friedman's public filings even though, as they then and there well knew and believed, these filings contained false and misleading statements regarding Friedman's operation of its installment credit program. These filings included the annual 10-K reports for the fiscal years ended September 29, 2001 and September 28, 2002, and February 2002 and September 2003 Prospectus Supplements filed in connection with offerings of Friedman's stock.

B. Misrepresentations Concerning the Delinquency and Collectibility of Friedman's Accounts Receivable

21. Friedman's failure to follow its own credit granting guidelines resulted in a rising number of uncollectible credit accounts. The defendant VICTOR SUGLIA, Friedman's Chief

Executive Officer and others concealed the increase in uncollectible credit accounts from investors by manipulating the data used in the calculation of Friedman's currency percentage, delinquency percentage and allowance for doubtful accounts reserve. The purpose and effect of these manipulations was to ensure that Friedman's publicly reported financial results did not reflect the full extent of Friedman's collection problems.

22. As a result of these manipulations, in multiple quarters, Friedman's reported a currency percentage that was materially higher and a delinquency percentage that was materially lower than the actual percentages. These manipulations also caused Friedman's to materially underreport its allowance for doubtful accounts. This false financial information was reported by Friedman's in its annual reports for the fiscal years ended September 29, 2001 and September 28, 2002, public documents and statements disclosing Friedman's quarterly results for multiple quarters in or about and between June 2002 and June 2003, and February 2002 and September 2003 Prospectus Supplements filed in connection with offerings of Friedman's stock.

23. These false statements gave shareholders and the investing public the misimpression that Friedman's was more likely to collect and less likely to charge off its outstanding credit accounts than it actually was. Accordingly, these false

statements misled Friedman's shareholders and the investing public about the future profitability of the Company.

24. Examples of these manipulations are set forth in the following paragraphs.

(1) <u>The X-Files Manipulation</u>

25. Prior to filing its report for the quarter ended June 2002, the defendant VICTOR SUGLIA, Friedman's Chief Executive Officer and others learned that due to a computer error, certain credit accounts totaling approximately $7.9 million had not aged properly. These files became known secretly within the Company as the "x-files" or the "turd" accounts. Friedman's computer system classified all of these x-files accounts as current, that is, as having no payment due and owing, even though the customers on approximately 58% of these accounts had not made a payment for 120 days or more, and the customers on approximately 17% of these accounts had not made a payment for 360 days or more. Under Friedman's publicly disclosed credit policies, the Company should have charged off, or removed from its books, all of the accounts on which the customer had not made a payment for 120 days or more. The accounts falling into this category added up to approximately $4.8 million dollars.

26. Contrary to Friedman's publicly disclosed policies, the Company did not remove any of the x-files accounts from its books as of the close of the June 2002 quarter.

Instead, SUGLIA, Friedman's Chief Executive Officer and others deliberately concealed the existence of the x-files from Friedman's outside auditor, its shareholders and the investing public.

27. Furthermore, with SUGLIA'S knowledge, for the quarter ending June 2002, Friedman's materially overstated its currency percentage by classifying all the x-files accounts as current. Likewise, SUGLIA and others caused Friedman's to materially understate its delinquency percentage by failing to classify any of the x-files accounts as delinquent. In addition, with the knowledge of SUGLIA, Friedman's Chief Executive Officer and others, Friedman's reported a currency percentage that was materially overstated and a delinquency percentage that was materially understated in the Company's annual report for fiscal year 2002 by continuing to mischaracterize the age the x-files.

28. Moreover, during conference calls with analysts involving the participation of individuals in multiple states, SUGLIA and Friedman's Chief Executive Officer made false statements about the Company's financial results and concealed the existence and impact of the x-files. For example, on or about July 23, 2002, Friedman's held a quarterly conference call to discuss earnings for the Company's third fiscal quarter ending June 29, 2002. During the call, SUGLIA and Friedman's Chief Executive Officer deliberately failed to disclose the existence

of the x-files. Rather than disclosing that the x-files had a material impact on, among other things, the Company's currency and delinquency percentages, SUGLIA falsely stated, in substance, that the performance of Friedman's credit portfolio was improving. In fact, as SUGLIA knew, the performance of Friedman's credit portfolio was getting worse. Specifically, SUGLIA knew that the information that he reported during the conference call about the currency percentage, delinquency percentage and the allowance for doubtful accounts was false and did not reflect Friedman's actual financial results.

(2) The Manipulation of the Allowance for Doubtful Accounts Reserve

29. In or about and between 2001 and 2003, Friedman's disclosed in its public filings that its allowance for doubtful accounts, that is, the portion of its outstanding accounts receivable that it expected to charge off in the future, was "estimated based on historical experience, the composition of outstanding balances, credit experience trends and other relevant information." The methodology used to compute Friedman's allowance for doubtful accounts reserve was known as the "migration analysis."

30. At the direction of Friedman's Chief Executive Officer, Friedman's reported an allowance for doubtful accounts reserve of 10% of total accounts receivable in its annual reports for fiscal years 2001 and 2002. As the defendant VICTOR SUGLIA

knew and believed, under a correctly performed migration analysis, Friedman's allowance for doubtful accounts reserve percentage should have been much higher than that reported in the 2001 and 2002 annual reports. To justify the 10% number to its outside auditor, SUGLIA and others created a fabricated analysis, referred to as the "supplemental migration analysis." The sole purpose of the supplemental migration analysis was to manipulate Friedman's accounting data in order to achieve an allowance for doubtful accounts percentage of 10%. As a result, SUGLIA and others caused Friedman's to deliberately underreport its allowance for doubtful accounts percentage in its annual reports for fiscal years 2001 and 2002.

31. Friedman's outside auditor questioned the supplemental migration analysis in early 2003. Based on discussions with representatives of the outside auditor, SUGLIA, Friedman's Chief Executive Officer and others knew that the Company's outside auditor would not approve its 2003 fiscal year end financial statement if Friedman's again reported an allowance for doubtful accounts percentage of only 10%. In response, instead of accurately estimating the Company's allowance for doubtful accounts, Friedman's Chief Executive Officer decided that Friedman's would incrementally increase the reserve by 0.5% each fiscal year. In furtherance of this scheme, SUGLIA and Friedman's Chief Executive Officer caused Friedman's to issue a

press release in July 2003 stating that it expected that it would report an allowance for doubtful accounts percentage of 10.5% in its 2003 annual financial statement, even though an internal analysis showed that the reserve should be a much higher percentage of the Company's total accounts receivable.

C. Manipulation and Lies Regarding Friedman's Earnings

32. The defendant VICTOR SUGLIA, Friedman's Chief Executive Officer and others also lied to Friedman's shareholders and the investing public about the Company's earnings. The term "earnings" referred to a company's net income. A related term, earnings per share, or "EPS," was an earnings measure reported to shareholders that indicated the amount of a company's income, on a per-share basis, that a company had available to pay dividends to common stockholders or to reinvest in itself. Earnings and EPS numbers were often used by analysts and investors to evaluate a company's expected future performance.

33. For each fiscal quarter, professional stock analysts predicted the earnings per share, or EPS, of Friedman's stock. The average of the estimates of the professional analysts was commonly referred to as the "consensus estimate." Friedman's senior management, including SUGLIA, understood that Friedman's failure to meet or exceed the consensus estimate for a fiscal quarter would likely result in a decrease in the Company's stock price.

34. In or about and between 2001 and 2003, Friedman's actual financial results did not meet the consensus estimate in multiple quarters. Instead of disclosing that information to the Company's auditors, its shareholders and the investing public, SUGLIA, Friedman's Chief Executive Officer and others engaged in a series of accounting manipulations that enabled the Company to report quarterly and annual financial numbers that were materially better than the Company's actual results. In some cases, the purpose and effect of these manipulations was to enable the Company's reported EPS to meet or exceed the consensus estimate when, as SUGLIA then and there well knew and believed, its actual results fell below the consensus estimate.

35. SUGLIA approved multiple filings and other public statements that he knew contained false EPS numbers, including Friedman's annual reports for the fiscal years ended September 29, 2001 and September 28, 2002, Friedman's quarterly reports for multiple quarters in or about and between June 2002 and June 2003, and February 2002 and September 2003 Prospectus Supplements filed in connection with offerings of Friedman's stock.

36. SUGLIA, Friedman's Chief Executive Officer and others used a variety of methods to falsify EPS. For example, Friedman's deliberately understated the negative impact of the x-files on earnings in its June 2002 and September 2002 financial reports. In these reports, Friedman's falsely reported an EPS

number that either met or exceeded the consensus estimate when, in fact, as SUGLIA knew and believed, Friedman's actual EPS would have been below the consensus estimate in both the June 2002 and September 2002 quarters if the x-files had been accounted for correctly.

37. Under GAAP, Friedman's also was required to reduce earnings by amounts added to its allowance for doubtful accounts reserve. Friedman's, with SUGLIA's knowledge, deliberately understated its allowance for doubtful accounts reserve at 2001 and 2002 fiscal year end, and thus overreported its EPS for these periods.

III. The End of the Scheme

38. On August 13, 2003, Friedman's was sued in a civil lawsuit. On September 8, 2003, the SEC notified Friedman's that it had opened an informal inquiry into the allegations contained in the lawsuit. On September 29, 2003, the United States Department of Justice notified Friedman's that it was conducting an investigation relating to the allegations asserted in the lawsuit.

39. On or about October 29, 2003, the Department of Justice and the SEC advised Friedman's that both entities were expanding their investigations to include a review of the Company's allowance for doubtful accounts reserve and other financial matters.

40. On November 11, 2003, Friedman's issued a press release announcing an increase of its allowance for doubtful accounts reserve for the 2003 fiscal year end. This press release stated that Friedman's expected its allowance for doubtful accounts reserve to be in the range of 14% to 17% of total accounts receivable, not the 10.5% reserve that had been disclosed in the July 2003 press release. The November 11, 2003 press release caused a significant drop in the stock price of Friedman's publicly traded shares. At the close of business on November 11, 2003, Friedman's class A common stock was priced at $11.99 per share. By the close of trading the next day, November 12, 2003, the Company's publicly traded stock fell to a price of $7.31 per share, a decrease of approximately 39%.

41. On or about November 11, 2003, Friedman's Board of Directors placed the defendant VICTOR SUGLIA on a leave of absence. SUGLIA subsequently resigned in December 2003.

42. On November 17, 2003, Friedman's announced that the Company's previously filed financial statements, for at least the fiscal years 2000, 2001, and 2002, and for the first three quarters of fiscal year 2003 would be restated.

CONSPIRACY TO COMMIT SECURITIES FRAUD, MAIL FRAUD AND WIRE FRAUD

43. On or about and between July 30, 2002 and December 2003, both dates being approximate and inclusive, within the Eastern District of New York and elsewhere, the defendant VICTOR

SUGLIA, together with others, did knowingly and intentionally conspire to: (1) execute a scheme or artifice (a) to defraud persons in connection with securities of an issuer with a class of securities that was registered under Section 12 of the Securities Exchange Act of 1934, to wit: the Class A common stock of Friedman's Inc., and (b) to obtain, by means of materially false and fraudulent pretenses, representations and promises, money and property in connection with the purchase and sale of securities of an issuer with a class of securities that was registered under Section 12 of the Securities Exchange Act of 1934, to wit: the Class A common stock of Friedman's Inc., in violation of Title 18, United States Code, Section 1348; and (2) devise a scheme and artifice to defraud shareholders and the investing public, and to obtain money and property from shareholders and the investing public by means of materially false and fraudulent pretenses, representations and promises, and for the purpose of executing such scheme and artifice, and attempting to do so, (a) to cause mail matter to be delivered by the United States Postal Service and commercial foreign and interstate carriers according to the directions thereon, in violation of Title 18, United States Code, Section 1341, and (b) to transmit and cause to be transmitted, by means of wire communication in interstate and foreign commerce, writings, signs, signals, pictures and sounds, in violation of Title 18, United States Code, Section 1343.

(Title 18, United States Code, Sections 1349 and 3551 et seq.)

ROSLYNN R. MAUSKOPF
UNITED STATES ATTORNEY
EASTERN DISTRICT OF NEW YORK

BY:
ACTING UNITED STATES ATTORNEY
PURSUANT TO 28 C.F.R. 0.136

FORM DBD.34
JUN.85

No. _ _ _ _ _ _ _ _

UNITED STATES DISTRICT COURT

EASTERN District of NEW YORK

THE UNITED STATES OF AMERICA

vs.

VICTOR SUGLIA,

Defendant.

INFORMATION

Cr. No. 07-033 (NG)
(T.18, U.S.C., §§ 1349 and 3551 et seq.)

A true bill.

_______________ Foreman

Filed in open court this ________ day.
Of ________ A.D. 19 ________

_______________ Clerk

Bail, $ ________

SCOTT KLUGMAN, AUSA 718-254-6461